

Payroll versus Per Employee As a Basis for Determining Workers' Compensation Premium

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Prevalence of Payroll

- All states except for Washington use payroll as the basis for determining rates.
- It's prevalence allows multi-state employers to manage their WC costs.
- It's prevalence allows multi-state insurers to easily compete.
- Washington has a monopolistic fund – all businesses that are not self-insured must purchase WC coverage from the state.

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Exposure Bases

An exposure base quantifies the exposure to insured loss, and should meet four criteria:

- Reasonability
- Ease of Use and Verification
- Responsiveness to Change
- Historical Practice

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Reasonability

- Payroll is directly related to indemnity benefits and is therefore directly related to insured loss.
- The number of employees is associated with the potential for loss since it is a direct measure of the workforce.

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Ease of Use and Verification

- Payroll is a business expense directly used in financial statements.
- Tracking payroll is fundamental to managing any business.
- The number of employees is also a key element of managing a business.
- Verification of employee counts requires inspection of personnel records, including confidential information.

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Responsiveness to Change

- Payroll is directly responsive to indemnity benefits.
- It grows and diminishes with the size of the workforce.
- Economic forces on medical costs are similar to those that affect payroll.
- The number of employees is a direct measure of the size of the workforce.
- As such, it is related to claim frequency.

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Historical Practice

- Over 300 classifications in the Delaware Workers' Compensation manual. All but a few are payroll based.
- A few domestic employee classes use a number of employees base.
- Only one state doesn't use payroll.
- The prevalence of payroll allows insurers to easily operate across state lines.
- It also simplifies WC premium for multi-state employers.

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Other Considerations

- Changing from payroll to number of employees would introduce cross subsidization.
- Low wage paying employers would pay more while high wage paying employers would pay less – with no change in the benefits paid to their injured employees.
- Payroll enhances competition and availability of coverage.
- Number of employees would aid cherry picking within each class.

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Meeting Requirements for a Strong Exposure Base

	Payroll	Number of Employees
Reasonability	Generally Meets	Generally Meets
Ease of Use/Verification	Strongly Meets	Generally Meets
Responsiveness	Strongly Meets	Generally Meets
Historical Practice	Strongly Meets	Weakly Meets
Reduces Cross Subsidization	Strongly Meets	Does Not Meet
Competition	Strongly Meets	Generally Meets
Cost of Changing	None	Raises Costs
Impact to Statewide Premium	None	Additional Expense

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Questions?

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